Petition

Supreme Court, U.S.
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81-1866
NO.

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1981

THE COMMONWEALTH NATIONAL BANK, PETITIONER

v.

CHARLES E. ASHE and SUSAN J. ASHE
t/a C&S FUEL SERVICE

and

THE UNITED STATES OF AMERICA, INTERVENOR

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether a lien on real estate which arises upon the filing of a promissory note contractually authorizing the confession of a judgment and executed in connection with a loan transaction is a judicial lien subject to avoidance under section 522(f)(1) of the Bankruptcy Code of 1978.

2. Whether a statute which retroactively impairs a creditor's lien on real property granted as security in a loan transaction is unconstitutional as a deprivation of property without due process of law.

TABLE OF CONTENTS

	Page
Questions presented for review	i
Table of Authorities	iii
Opinions below	1
Jurisdiction	2
Constitutional and statutory provisions involved	2
Statement of the case	3
Reasons for granting the petition	7
Conclusion	9
Appendix A	1a
Appendix B	15a
Appendix C	16a
Appendix D	17a

TABLE OF AUTHORITIES

Cases:

	Page
The Commonwealth National Bank v. Charles E. Ashe and Susan J. Ashe and The United States of America, 669 F. 2d 105 (3rd Cir. 1982).	1
In re: DeBose, 16 B.R. 881 (9th Cir. 1982)	7
Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1939) . .	8
In re: Rodrock, 642 F. 2d 1193 (10th Cir. 1981), appeal pending (S. Ct. 1982)	7

Constitution and statutes:

United States Constitution: Fifth Amendment	2
The Act of June 25, 1948, C. 646, 62 Stat. 928, 28 U.S.C. §1254	2
Bankruptcy Reform Act of 1978 Pub. L. 95-598, November 6, 1978, 92 Stat. 2549, 11 U.S.C. §522(f)(1)	2, 3, 6
Bankruptcy Reform Act of 1978 Pub. L. 95-598, November 6, 1978 92 Stat 2549, 11 U.S.C. §522(f)(2)	7
Bankruptcy Reform Act of 1978 Pub. L. 95-598 Title 11 §241(a) 92 Stat. 2668	5

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THE UNITED STATES OF AMERICA, INTERVENOR

PETITION FOR A WRIT OF CERTIORARI TO THE
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The Commonwealth National Bank, petitions for a Writ of Certicrari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals for the Third Circuit (App. A, infra. 1a-14a) is reported at 669 F. 2d 105 (3rd Cir. 1982). The Opinion of the Bankruptcy Court for the

Middle District of Pennsylvania (App. D infra. 17a-20a) has not been officially reported.

JURISDICTION

The judgment of the Court of Appeals (App. B., infra, 15a) was entered on Janury 6, 1982. A Petition for Rehearing was denied on February 3, 1982 (App. C., infra. 16a). The jurisdiction of this Court is invoked under the Act of June 25, 1948, C. 646, 62 Stat. 928, codified at 28 U.S.C. §1254.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The Fifth Amendment to the United States Constitution provides in relevant part as follows:

> "No person shall ... be deprived of life, liberty, or property, without due process of law ..."

2. Section 522(f)(1) of the Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat.

2549,provides as follows:

> "(f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is -
>
> (1) a judicial lien;" 11 U.S.C. §522(f)(1).

STATEMENT OF THE CASE

1. The Petitioner, The Commonwealth National Bank, holds a valid and enforceable lien upon the residence property of the debtors in bankruptcy in this case, Charles E. Ashe and Susan J. Ashe t/a C&S Fuel Service ("Debtors"). This action arose when the Debtors sought to avoid that lien pursuant to Section 522(f)(1) of The Bankruptcy Reform Act of 1978 ("Bankruptcy Code") enacted by Congress on November 6, 1978, effective October 1, 1979. This section allows debtors to avoid judicial liens to the extent judicial liens impair an exemption on their property to which the debtors otherwise would have been entitled.

2. On December 26, 1973, the Debtors borrowed money in a commercial loan transaction from The Commonwealth National Bank for which the Debtors' property, including their residence, was collateral. The loan, in the amount of Forty Five Thousand Two Hundred Eighty-Seven and 62/100 ($45,287.62) Dollars, was evidenced by a Promissory Note containing a confession of judgment clause. Judgment was entered on the note in the Dauphin County Court of Common Pleas on the same date the loan was made. Under Pennsylvania law, this judgment, when entered, became a lien upon all of the Debtors' real property in that county, including their residence.

3. Five years later, on October 10, 1978, the Debtors filed a Petition in bankruptcy under the new Bankruptcy Code. The amount of liens encumbering their residence exceeded its value. The Debtors claimed joint exemptions upon their residence in the amount of Fifteen Thousand and 00/100 ($15,000.00) Dollars. The Commonwealth National Bank filed objections in the

Bankruptcy Court to the exemptions for three reasons:

(a) That the Debtors had no equity in their residence upon which to claim their joint exemptions;

(b) That The Commonwealth National Bank's lien was not a judicial lien subject to avoidance; and

(c) That The Commonwealth National Bank's lien, security for its loan, could not be constitutionally retroactively avoided.

4. The Bankruptcy Court of the Middle District of Pennsylvania, having jurisdiction of the matter pursuant to 28 U.S.C. §1471, held a hearing on The Commonwealth National Bank's objections at which it was agreed between counsel for the Debtors and The Commonwealth National Bank that the facts were as set forth above and not in dispute. Thereafter, The Commonwealth National Bank filed a Notification of Claim of Unconstitutionality pursuant to Federal Rule of Civil

Procedure 24(c), following which the Court certified to the United States Attorney General that the constitutionality of the Bankruptcy Code was at issue and the United States intervened. The legal isuses were briefed and orally argued by counsel for The Commonwealth National Bank and by the Department of Justice for The United States of America.

The Bankruptcy Court held that The Commonwealth National Bank's lien was a "judicial lien" and that Section 522(f)(1) of the Bankruptcy Code could constitutionally be retroactively applied to avoid such liens. Pursuant to the Bankruptcy Code, Pub. L. 95-598, November 6, 1978, 92 Stat. 2549, by agreement of the parties, a direct appeal was taken to the Third Circuit Court of Appeals.

On appeal, a three-judge panel of the Third Circuit Court of Appeals affirmed the Bankruptcy Court, despite the holding of the 10th Circuit Court of Appeals in In re: Rodrock, 642 F. 2d 1193 (10th Cir. 1981)

appeal pending (S. Ct. 1982), that the retroactive avoidance of a lien under the new Bankruptcy Code was unconstitutional.

REASONS FOR GRANTING THE PETITION

1. Conflict with other Circuit Decisions. This case presents an important question as to the constitutionality of retroactively avoiding liens under the new Bankruptcy Code. The 3rd Circuit Court of Appeals' decision in this case is in conflict with the decisions of the Tenth Circuit Court of Appeals in In re: Rodrock, 642 F. 2d 1193 (10th Cir. 1981), appeal pending (S. Ct. 1982), presently pending before this Court and the Ninth Circuit in In re: DeBose, 16 B.R. 881 (9th Cir. 1-12-82). Both Rodrock and DeBose hold retroactive application of §522(f)(2) unconstitutional. These two decisions involve the other type of lien subject to avoidance under the new Bankruptcy Code - a "nonpossessory, nonpurchase-money security

interest" lien - a type of lien certainly entitled to no greater protection than a judicial lien.

2. Important Constitutional Question Involving Viability of Previous Decision of this Court.

Retroactive application of bankruptcy legislation affecting property rights of creditors was held by this Court to be unconstitutional under the Fifty Amendment to the Constitution of the United States in Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1939), 70 L. Ed. 1116 (1935). The Radford case remains sound despite the Third Circuit's characterization in this case of Radford as "discredited" and "effectively limited if not tacitly overruled ..." (Opinion, App. A, 12a).

3. Issue of First Impression Involving Nature of Liens Subject to Avoidance.

This case also represents an important question concerning whether Congress intended

a lien on real property granted as security in a loan transaction to be a "judicial lien" subject to avoidance under the Bankruptcy Code.

CONCLUSION

It is respectfully submitted, for the reasons set forth above that the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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April 5, 1982

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Appendix

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1629

In re: CHARLES E. ASHE AND SUSAN J. ASHE
t/a C & S FUEL SERVICE,

Debtors

THE COMMONWEALTH NATIONAL BANK,

Objector

v.

UNITED STATES OF AMERICA,

Intervenor

The Commonwealth National Bank,
Creditor-Objector,

Appellant

(D.C. Bankruptcy No. 1-79-00882)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA
(Bankruptcy Court — Wilkes-Barre)

Argued: November 19, 1981

Before: GIBBONS and HIGGINBOTHAM, *Circuit Judges*
and MEANOR, *District Judge**

(Opinion Filed: January 6, 1982)

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*Hon. H. Curtis Meanor, United States District Judge for the District of New Jersey, sitting by designation.

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OPINION OF THE COURT

GIBBONS, *Circuit Judge.*

This appeal presents questions of first impression: the applicability to Pennsylvania cognovit notes of the exemption provision of Section 522(f) of the Bankruptcy Reform Act of 1978, 11 U.S.C. §522(f) (Supp. III 1979); and if that section is applicable to cognovit notes, its constitutionality. The case is before us on appeal from a bankruptcy judge upon agreement of the parties under that Act, Pub. L. No. 95-598, Title IV, §405, 92 Stat. 2685 (1978). The bankruptcy judge held that the lien of a cognovit note was a judgment lien subject to avoidance to the extent permitted by Section 522, and that as applied the section is constitutional. We affirm.

I.

In 1973, Charles E. Ashe and Susan J. Ashe (the Debtors) borrowed $45,287.62 from the Commonwealth National Bank (the Bank). This commercial loan was evidenced by a promissory note containing a confession of judgment clause in the form commonly used in Pennsylvania. The judgment note was duly filed with the Prothonotary's Office of the Court of Common Pleas of Dauphin County. At that time the Debtors owned two

pieces of real estate in Dauphin County, one of which was their residence. The note was refiled in 1978 in the amount of $43,733.47. The loan became delinquent, and on May 30, 1979, the Bank filed a complaint in assumpsit in the Court of Common Pleas of Dauphin County. This action was necessary because under Pennsylvania law, in order to obtain a writ of execution on residential property, a separate action is required in addition to the cognovit note judgment. Judgment in the separate action merges, so that the judgment lien relates back to the date the confessed judgment note was filed.[1] The Bank obtained a default judgment for $54,010.83, and a writ of execution was issued on August 31, 1979. An execution sale was scheduled for October 11, 1979, but on October 10, the Debtors filed a Petition under Chapter 7 of the Bankruptcy Reform Act, 11 U.S.C. §701 et seq. This resulted in a stay of the execution sale.

The Bankruptcy Reform Act provides that " . . . an individual debtor may exempt from property of the estate . . . property that is specified in subsection (d). . . ." 11 U.S.C. §522(b)(1). Subsection (d) permits exemption of

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1. "As to any residential real property, a plaintiff shall not have the right to levy, execute or garnish on the basis of any judgment or decree on confession, whether by amicable action or otherwise, or on a note, bond or other instrument in writing confessing judgment until plaintiff, utilizing such procedures as may be provided in the Pennsylvania Rules of Civil Procedure, files an appropriate action and proceeds to judgment or decree against defendant as in any original action. The judgment by confession shall be changed as may be appropriate by a judgment, order or decree entered by the court in the action. After the above mentioned original action has been prosecuted and a judgment obtained, that judgment shall merge with the confessed judgment and the confessed judgment shall be conformed as to amount and execution shall be had on the confessed judgment. The parties to the action shall have the same rights as parties to other original proceedings. Nothing in this act shall prohibit a residential mortgage lender from proceeding by action in mortgage foreclosure in lieu of judgment by confession if the residential mortgage lender so desires." Act of Jan. 30, 1974, P.L. 13, No. 6, §407(a), as amended, Act of Oct. 5, 1978, P.L. 1100, No. 258, §1, Pa. Stat. Ann. tit. 41, §407(a) (Purdon Supp. 1981-82).

"[t]he debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor . . . uses as a residence. . . ." 11 U.S.C. §522(d)(1). The debtors claimed exemptions with respect to their Dauphin County residence in the aggregate amount of $15,000. When their bankruptcy petition was filed the fair market value of the residence did not exceed $50,000, while encumbrances on it listed on their Bankruptcy Schedule A-2 (Creditors Holding Security) totaled $85,244.79. These encumbrances included liens having priority under Pennsylvania law over that of the Bank totaling $9,118.49. Thus the prior encumbrances and the Bank's lien exceeded the fair market value of the residence.

The Bankruptcy Reform Act also provides that "[n]otwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is — (1) a judicial lien. . . ." 11 U.S.C. §522(f)(1). The Bank filed a timely objection to the allowance of the $15,000 exemption insofar as its lien would be impaired, but after a hearing the Bankruptcy Court held that the lien was a judgment lien, avoidable by virtue of Section 522(f)(1). The economic effect of this ruling is to increase interests in the residence having priority over the Bank's lien by $15,000. Thus if an execution sale brought a bid of $50,000 the Bank would recover only $25,881.51, rather than $40,881.51. The Bank contended that if Section 552(f)(1) was so applied, it was unconstitutional. That contention was rejected by the Bankruptcy Court, and this appeal followed.[2]

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2. All Bankruptcy Courts in Pennsylvania which have considered these issues have reached similar conclusions. In re Burkholder, 11 B.R. 346 (Bk. E.D. Pa. 1981); In re Smith, Bk. No. 5-80-00081 (Bk. M.D. Pa. 1980); In re Eminhizer, Bk. No. 1-80-00090 (Bk. M.D. Pa. 1980); In re Natale, 5 B.R. 454 (Bk. E. D. Pa. 1980).

II.

The Bank contends that the court erred in holding that the lien of a cognovit note is a judicial lien within the meaning of Section 522(f)(1). Since a decision in its favor on that question would avoid the necessity for considering the Bank's contention that the law is unconstitutional, we turn to that question first. The term "judicial lien" is defined in the Bankruptcy Reform Act as a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. §101(27). The term "lien" is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. §101(28). Thus a "judicial lien" is a charge against or interest in property to secure payment of a debt, obtained by judgment or other legal proceedings. Only such liens are avoidable under Section 522(f)(1). A "security interest", defined as a "lien created by an agreement," 11 U.S.C. §101(37), is not avoidable under that section.[3] Thus a mortgage, for example, is a lien, since it is a charge against or interest in property to secure payment of a debt. It is not, however, affected by Section 522(f)(1) because the charge against or interest in property is created by a conveyance or contract rather than by a judgment or other legal proceeding.

Under Pennsylvania law a confession of judgment for money "may be entered by the prothonotary . . . without the agency of an attorney and without the filing of a complaint, declaration, or confession, for the amount which may appear to be due from the face of the instrument." Pa. Rules Civ. P. 2951(a), 42 Pa. Cons. Stat. Ann. (Purdon 1975).[4] Once entered, the judgment

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3. The Bankruptcy Act also recognizes "statutory liens". 11 U.S.C. §101(38), but they are not relevant for purposes of this case.

4. *See generally, Goodrich-Amram 2d*, "Confession of Judgment for Money", §§2950:1, et seq.; Shuchman, *Handbook on the Use of Judgment Notes In Pennsylvania (1961)*.

note, as in the case of a litigated judgment, results in a lien upon all real property of the debtor in the county of filing. 42 Pa. Cons. Stat. Ann. §4303 (Purdon 1981); *Scott Factors, Inc. v. Hartley*, 425 Pa. 290, 228 A.2d 887 (1967); *In re Fell*, 18 F. Supp. 989 (E.D. Pa. 1937). Moreover, the priority of such liens is determined by the date they are left for entry by the prothonotary. 42 Pa. Cons. Stat. Ann. §8141 (Purdon Pamph. 1981). As a practical matter, therefore, the taking of a cognovit note in connection with a loan to an owner of real estate serves most of the same functions as a mortgage. The chief difference between the two security devices is that a mortgage requires a conveyance of specific property, while the cognovit note creates a lien on all real property of the debtor in the county, with no need for a description or conveyance. The Bank contends that because cognovit notes are consensual undertakings they should be treated, like mortgages, as "security interests" rather than "judicial liens." But that is equally true of consent judgments settling initially litigated matters. With either, the *lien* is created not by the agreement, but by the judgment. Literally, both a filed cognovit note and a consent judgment fit within the definition of "judicial lien" in 11 U.S.C. §101(27).

When Congress wrote the definition of judicial lien and security interest the cognovit note problem was not unknown. Under prior sections 60 and 61 of the Bankruptcy Act dealing with voidable preferences including liens obtained by judgment, those obtained by confession were considered to be ordinary judgment liens. *See In re Fell*, 18 F. Supp. 989, 991 (E.D. Pa. 1937); *Nogi v. Greenwood*, 1 F. Supp. 60, 62-63 (M.D. Pa. 1932); *In re Albright*, 18 F.2d 591, 592 (E.D. Pa. 1927), *aff'd sub nom. Shick v. Goodman*, 33 F.2d 291 (3d Cir.), *cert. denied*, 280 U.S. 561 (1929); *Greenberger v. Schwartz*, 261 Pa. 265, 104 A. 573 (1918); 4 *Collier on Bankruptcy* 116, ¶67.08 n.1 (14th ed. 1978). Given that background,

and in the absence of any indication in the legislative history of the Bankruptcy Reform Act that something else was intended, we would not be justified in rewriting Section 522(f)(1) and Sections 101(27) and (28) so as to treat cognovit note judgment liens differently from all other judgment liens. Thus we reject the Bank's contention that Section 522(f)(1) is inapplicable.

III.

The holding in Part II requires the consideration of the Bank's constitutional challenge. It contends that prior to the enactment of the Bankruptcy Reform Act it had a valid property interest under Pennsylvania law in all the Debtor's real estate in Dauphin County, and that retroactive application of the exemption provision in Section 522(f)(1) would be a taking of that property interest, to the extent of $15,000, without due process of law. In advancing that contention the Bank relies chiefly on *Louisville Joint Stock Bank v. Radford*, 295 U.S. 555 (1935), which held unconstitutional certain provisions of the Frazier-Lemke Act, Pub. L. No. 486 ch. 869, 48 Stat. 1289 (1934). The United States, which intervened in the action pursuant to 28 U.S.C. §2403, contends that Section 522(f)(1) applies to liens of cognovit notes filed prior to its enactment, and that such application does not violate the Fifth Amendment.

In approaching the consideration of the Bank's constitutional claim it is appropriate to narrow the inquiry by reference to issues which are not involved. The Bank makes no contention that congressional power to make "uniform Laws on the subject of Bankruptcies"[5] does not include the power to provide a uniform minimum standard for exemptions.[6] Nor does the Bank contend

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5. U.S. Const. art. I, §8, cl. 4.

6. *Cf.* Hanover National Bank v. Moyses, 186 U.S. 181, 189-90 (1902) (recognition in Bankruptcy Act of 1898 of state exemption law is valid).

that a Bankruptcy law is unconstitutional which retroactively discharges debtors from the state law property interests represented by their otherwise enforceable contractual undertakings.[7] It is no objection to Bankruptcy legislation that it may affect preexisting relationships under state law. Indeed the retroactive alteration of legal relationships is the essence of such legislation.

Moreover we are not dealing with the analytically distinct Fifth Amendment problem of taking private property for public use without just compensation. The taking clause of the Fifth Amendment imposes a distinct substantive standard — just compensation — when private property is diverted to public uses, even when the diversion takes place in the course of a bankruptcy proceeding. *See Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974); *New Haven Inclusion Cases*, 399 U.S. 392 (1970); *In re Penn Central Transportation Company*, 494 F.2d 270, 278-79 (3d Cir. 1974). That substantive rule has been incorporated into the Fourteenth Amendment due process clause with respect to state takings for public purposes. *Brooks-Scanlon Co. v. Railroad Commission of Louisiana*, 251 U.S. 396 (1920). It has nothing to do, however, with legislation which, while it affects the existence or value of a property right, does not devote the property to public use. The line between governmental regulation and taking for public use may not always be distinct. *Compare Agins v. Tiburon*, 447 U.S. 255 (1980); *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978); and

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7. *Compare* Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122 (1819) (state insolvency law applicable to contracts made prior to its enactment violates impairment of contracts clause) *with* Hanover National Bank v. Moyses, 186 U.S. 181, 188 (1902) ("The subject of 'bankruptcies' includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property. The grant to Congress involves the power to impair the obligation of contracts, and this the States were forbidden to do.").

Euclid v. Ambler Realty Co., 272 U.S. 365 (1926) with *Griggs v. Allegheny County*, 369 U.S. 84 (1962); *Armstrong v. United States*, 364 U.S. 40 (1960); *United States v. Causby*, 328 U.S. 256 (1946); and *Nectow v. Cambridge*, 277 U.S. 183 (1928). But the consequences of classifying a law as an economic regulation rather than a taking for public use are clear. Only if a taking for public use is found does the just compensation standard apply. Plainly Section 522(f)(1) is an economic regulation rather than a taking for public use. If the exemption works a taking, it is a taking for the private use of the Debtors, not for the general use of the public or the particular use of a governmental agency.

The question, then, is a narrow one: to what extent does the due process clause of the Fifth Amendment place substantive limits upon the plenary grant of legislative authority in the bankruptcy clause of the Constitution. The government urges, and we agree, that federal bankruptcy legislation is classic economic regulation legislation, and should be measured, absent a taking for public use, for substantive due process purposes by the standard generally applicable to such legislation. Since *United States v. Carolene Products Co.*, 304 U.S. 144 (1938), economic regulation has been sustained against substantive due process challenges if it rests upon a rational basis. *See, e.g., Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1 (1976); *Williamson v. Lee Optical Co.*, 348 U.S. 483 (1955).

Certainly the congressional decision reflected in Section 522(f)(1) to establish a federal minimum exemption, with state exemptions as an alternative, is a rational resolution of the competing interests of debtors seeking rehabilitation and creditors seeking payment. Homestead exemptions created by state law successfully met constitutional challenges prior to the enactment of the Bankruptcy Act of 1898. *Denny v. Bennett*, 128 U.S. 489 (1888). Congressional authority to leave a debtor

with what it considers to be the wherewithal necessary for a fresh start in economic life is at least as broad.

The Bank urges, however, that while Congress exercising its bankruptcy powers can exempt property from the reach of general unsecured creditors, it cannot affect the "property" rights of secured creditors under state law. There was a time, prior to *Carolene Products*, when that position might command respectful attention. But judges are no longer free to impose through the due process clause of the Fifth Amendment their own views as to substantive limitations upon plenary grants of congressional legislative authority. It is settled that federal bankruptcy law can eliminate vested property rights in contractual undertakings sanctioned by state law. There is no reason why that plenary power may not, if Congress should say so, operate on property rights, originating out of contractual undertakings, which state law recognizes as liens upon specific property.[8] If Congress goes too far in undermining the security for extensions of credit when exercising plenary legislative power under the bankruptcy clause, the result may be that credit will be unavailable. But that is a matter of policy judgment for the legislative branch. It has chosen in Section 522(f)(1) to strike the balance between security for obligations and rehabilitation for debtors by subjecting those state law property interests resulting from judicial liens to a federal homestead exemption, while leaving intact mortgages on specific property. It might have gone further. But the choice it made to subject only judgment liens to the exemption certainly satisfies rational basis review.

We recognize that *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), is significant authority suggesting that substantive due process limitations on the bankruptcy power are greater than we have recognized. For several reasons we conclude that it is not controlling. First, despite the eminence of its author, the

opinion hopelessly confuses the problem of taking property for public use without compensation with the distinct problem of substantive due process limitations upon plenary congressional legislative powers. *See* 295 U.S. at 601. The taking analysis simply cannot be reconciled with that made in the cases referred to above, distinguishing between regulation on the one hand and taking for public use on the other. If *Radford* stands for the proposition that the just compensation standard applies to economic regulations which have the effect of changing the relative economic positions of property owners, it has been discredited by those cases. Second, as a substantive due process holding, the intense scrutiny the opinion applied to the Frazier-Lemke Act is entirely inconsistent with the standard for such scrutiny announced in *Carolene Products* and its progeny. Finally, even before *Carolene Products*, *Radford* was effectively limited, if not tacitly overruled, by the decision in *Wright v. Vinton Branch of the Mountain Bank of Roanoke*, 300 U.S. 440 (1937), upholding a slightly revised version of the Frazier-Lemke Act. *See Helvering v. Griffiths*, 318 U.S. 371, 400-401 & n.52 (1943).

IV.

We hold, then, that Section 522(f)(1) applies to cognovit note judgment liens, and that as applied it is constitutional.

The judgment appealed from will be affirmed.

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

(A.O. U. S. Courts. The Legal Intelligencer, Phila., Pa.) 55

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 81-1629

In re: CHARLES E. ASHE and SUSAN J. ASHE
t/a C & S FUEL SERVICE,

Debtors

THE COMMONWEALTH NATIONAL BANK,

Objector

v.

UNITED STATES OF AMERICA,

Intervenor

The Commonwealth National Bank,
Creditor-Objector,

Appellant

(D.C. Bankruptcy No. 1-79-0082)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

(Bankruptcy Court — Wilkes-Barre)

Argued: November 19, 1981

Before: GIBBONS and HIGGINBOTHAM, *Circuit Judges*
and MEANOR, *District Judge**

(Opinion Filed: January 6, 1982)

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*Hon. H. Curtis Meanor, United States District Judge for the District of New Jersey, sitting by designation.

ORDER AMENDING OPINION

The slip opinion in the above matter is hereby amended as follows:

Page 5

In line 7, insert a comma after "filed"

Page 7

In line 1 of the first full paragraph, "definitions" is substituted for "definition"

In line 2 of that paragraph, insert a comma after "interest"

Page 10

In line 1, "with" should be italicized

Page 11

Footnote 8, although referenced in the printed text and included in the typescript, was omitted from the slip opinion. It should be inserted as followed:

"8. *But see* Rodrock v. Security Industrial Bank, 642 F.2d 1193 (10th Cir. 1981), *cert. granted sub nom.* U.S. v. Security Industrial Bank, 50 U.S.L.W. 3479 (U.S. Dec. 15, 1981), holding that application of Section 522(f) to liens created by state law prior to its enactment is unconstitutional. We decline to follow that holding."

JOHN J. GIBBONS

Circuit Judge

DATED: January 26, 1982

A True Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit

(A.O. U. S. Courts, The Legal Intelligencer, Phila., Pa.)

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 81-1629

In re: CHARLES E. ASHE AND SUSAN J. ASHE
t/a C & S FUEL SERVICE,
Debtors

THE COMMONWEALTH NATIONAL BANK, Objector

vs.

UNITED STATES OF AMERICA, Intervenor

The Commonwealth National Bank, Creditor-Objector,
Appellant

(Bankruptcy No. 1-79-00882)

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

Present: GIBBONS and HIGGINBOTHAM, Circuit Judges
and MEANOR, District Judge*

JUDGMENT

This cause came on to be heard on the record from the United States Bankruptcy Court for the Middle District of Pennsylvania and was argued by counsel on November 19, 1981.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said Bankruptcy Court, entered March 11, 1981, be, and the same is hereby affirmed. Costs taxed against appellant.

ATTEST:

Clerk

January 6, 1982

*Honorable H. Curtis Meanor, United States District Judge for the District of New Jersey, sitting by designation.

United States Court of Appeals

FOR THE THIRD CIRCUIT

No. 81-1629

In re: CHARLES E. ASHE AND SUSAN J. ASHE
S/a C & S Fuel Service,
Debtors
THE COMMONWEALTH NATIONAL BANK,
Objector

v.

UNITED STATES OF AMERICA
Intervenor
The Commonwealth Nationak Bank,
Creditor-Objector
Appellant

(D.C. Bankruptcy No. 1-79-00882)

SUR PETITION FOR REHEARING

Present: SEITZ, Chief Judge, ALDISERT, ADAMS, GIBBONS, HUNTER, WEIS, GARTH, HIGGINBOTHAM and SLOVITER, Circuit Judges, and MEANOR, District Judge

The petition for rehearing filed by

Appellant

in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

Judge Garth would grant rehearing.

By the Court,

John J. Gibbons
Judge

Dated: February 3, 1982

UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA

IN RE:	:	
CHARLES E. ASHE and SUSAN J. ASHE, husband and wife, Debtors	:	
	:	BK NO. 1-79-00882
THE COMMONWEALTH NATIONAL BANK, Objector	:	
UNITED STATES OF AMERICA, Intervenor	:	
	:	
	:	
	:	

MEMORANDUM AND ORDER

AVOIDING LIEN

This proceeding presents the issue of the constitutionality of retroactive application of section 522(f)(1) of the Bankruptcy Reform Act of 1978 (the Code) to a Pennsylvania judgment lien obtained by confession of judgment on a promissory note received from the debtors in a comercial loan transaction.

The transaction and the entry of judgment occurred on December 26, 1973. Upon entry of the judgment, Commonwealth National Bank (the Bank) automatically obtained a lien on debtors' residential real estate. Clark v. Dotter, 54 Pa. 215 (1867); Sellers v. Bank, 47 Pa. 344 (1864). Act of July 3, 1947, P.L. 1234, §2, 12 P.S. §78 (current version at 42 Pa. C.S.A. §4303 (1976)). It was the only real estate the debtors owned at the time. The debtors filed a bankruptcy petition on October 10, 1979. They claim a $15,000 exemption in their residential real estate under section 522(d)(1) of the Code. Due to the fact that the Bank's judgment lien impairs the debtors' exemption, debtors seek to avoid the fixing of the lien pursuant to section 522(f)(1), which provides as follows:

(f) Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is (1) a judicial lien; . . . .

The issue of avoidance is not raised in the pleadings, but counsel have agreed that it be determined at this juncture, in order to expedite resolution.

The Bank objects to avoidance of its lien for two reasons. First, it argues that its lien is not a judicial lien. Second, it argues that, if the lien is a judicial lien, avoidance is dependent on retroactive application of the Code and that such application violates the Fifth Amendment of the Constitution by depriving the Bank of a property right without substantive due process of law.

NATURE OF LIEN

The threshold question is the nature of the lien involved. The Bank's position is that the lien is a security interest, or a statutory lien. It has been determined in this District and elsewhere in Pennsylvania that a lien obtained by confession of judgment is a judicial lien. In re Smith, Bk No. 5-80-00081 (M.D. Pa. Bk Ct., Dec. 10, 1980); In re Steinhizer, Adv. No. 1-80-0050 (M.D. Pa. Bk Ct., July 8, 1980); In re Natale, 5 B.R. 454 (E.D. Pa. Bk Ct. 1980); see also, 4 Collier on Bankruptcy 116, 867.08, ftnt. 1 (14th ed. 1978). Being a judicial lien, it is subject to avoidance, provided that avoidance is not constitutionally proscribed.

AVOIDANCE OF PRE-CODE LIEN

The Bankruptcy powers of Congress are established in the Constitution U.S. Const., Art. I, §8. However, they are not unfettered. Where property rights are involved, the exercise of the Congress' power to legislate in the field of Bankruptcy is subject to a limitation imposed by the Fifth Amendment which provides that "No person...shall be...deprived of life, liberty, or property, without due process of law...." Specific property rights held prior to legislative enactment may not be taken without just compensation. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 55 S.Ct. 854, 79 L.Ed. 1593 (1935); Ginsberg v. Lindel, 107 F.2d 721 (8th Cir. 1939). See also, 8 C.J.S., Bankruptcy § 5.

The crucial question remains: Is the Bank's lien within the scope of the protection established by Radford? In the resolution of this question

every presumption of constitutionality to which the statute is susceptible should be applied, for the presumption of constitutionality is a strong one. U.S. v. DiRe, 332 U.S. 581, 68 S. Ct. 222, 92 L. Ed 210 (1948).

The general issue which confronts us was determined in another bankruptcy court recently in the case In re Oldham, 7 B.R. 124 (1980), decided November 19, 1980. There the Court held that retroactive application of the lien avoidance provision of the Code is unconstitutional in that it deprives holders of liens created before the Code's enactment date of their property without due process. In discussing the constitutionality issue, the Court relied on Radford and the recent cases of In re Hoops, 3 B.R. 635 (Colo. 1980) and Rodrock v. Security Industrial Bank, 3 B.R. 629 (Colo. 1980). The Court concluded that "the directive of Radford is inescapable: the bankruptcy power of Congress is subject to the Fifth Amendment, and bankruptcy legislation which substantially impairs pre-existing security interests is unconstitutional."

We consider that the ruling of Radford is firmly entrenched, but there is a significant difference between the property interest in Radford and the lien here involved. In Radford, the creditor held a mortgage. The creditor's interest was an actual property right at its inception: it was both choate and specific upon the execution of the mortgage.

In contrast, the Bank's lien in the case before us is general and, non-specific. Under Pennsylvania law:

> ...a judgment is a general and not a specific lien. If there be personal property of the debtor it is to be satisfied out of that. If not it is a lien on all his real estate without discrimination. Hence, the creditor is not interested in the property as property, but only in his lien.

Grevemeyer v. Southern Mutual Fire Insurance Co., 61 Pa. 340 (1867). The Bank did not obtain either a legal or an equitable right in the debtors' residence at the inception of the transaction with the debtors. It obtained a judgment which established a lien on whatever real property the judgment debtor had at the time of judgment entry. Furthermore, contrary to its claim, the Bank did not obtain a security interest. The Code defines a security interest as "...a lien created by agreement." Sec 101(37). The Bank's lien is a charge against property, but it is not an interest in property.

We consider that the Radford umbrella shields property interests which are contractually specific in the sense that the property interest in Radford was specific. The lien of the plaintiff is not such an interest. For that reason, it is our decision that avoidance is not constitutionally proscribed as claimed by the Bank.

We have considered the extensive briefs of all parties, including those of the United States, intervenor, and the amicus curiae. They are scholarly and have been helpful.

ORDER

AND NOW, this 11th day of March, 1981, it is determined that the judicial lien of the Commonwealth National Bank is avoidable. It is hereby avoided to the extent that it impairs the debtors' residential exemption.

BY THE COURT:

Thomas Rood
Bankruptcy Judge

HARRISBURG, PENNSYLVANIA

Supplemental Brief

Office-Supreme Court, U.S.
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IN THE SUPREME COURT OF THE
UNITED STATES

OCTOBER TERM, 1981

NO. 81-1866

THE COMMONWEALTH NATIONAL BANK, PETITIONER

v.

CHARLES E. ASHE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI

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SUPPLEMENT TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

AND NOW, The Commonwealth National Bany, by its counsel, Campbell, Spitzer, Davis & Turgeon, files this Supplement to discuss the application of this Honorable Court's recent unanimous decision in United States v. Security Industrial Bank, et al., 51 L.W. 4007, _____ U.S. _____ (Nov. 30, 1982) to the issues raised by the Bank in its Petition for a Writ of Certiorari:

1. This Court recently unanimously held in Security Industrial Bank, supra, that Section 522(f)(2) of the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (the 1978 Act) was not intended to apply retrospectively to abrogate liens acquired prior to its enactment date because any other construction would raise substantial constitutional doubts.

2. It is respectively submitted that the Security Industrial Bank decision increases the substantiality of the constitutional question in this case and provides controlling authority in support of the Bank's Petition and mandates immediate reversal of the court below in this case.

3. In Security Industrial Bank, the security interest destroyed was a non-possessory, non-purchase money security interest in household goods. Here, the security interest destroyed is a lien upon real estate. These property rights are more substantial and the issue of the low resale value of household goods raised in Security Industrial Bank is not present here.

4. The issues in this case parallel the issues addressed in Security Industrial Bank: the retrospective application of the lien avoidance provisions of the 1978 Act in Sections 522(f)(1) and 522(f)(2).

5. The Third Circuit Court's decision in this case is clearly contrary to this Court's decision in Security Industrial Bank, supra.

6. The Third Circuit's decision in this case has been effectively overruled as follows:

(a) The Third Circuit held that Section 522(f)(1) applied retrospectively to avoid secured creditor judgment liens.

This Court in Security Industrial Bank held otherwise. (Slip op. pp.3-8).

Both subsections (1) and (2) of the 1978 Act's lien avoidance provision (Section 522(f)) destroy secured creditors' liens. Both are property rights under state law but judgment liens against real estate are entitled to even greater protection.

(b) The Third Circuit dismissed the Bank's argument that the retrospective application of Section 522(f)(1) constituted a taking within the prohibition of the Fifth Amendment on the basis that the 1978 Act's lien avoidance

provision was an "economic regulation", rather than a "taking for public use" and that the case of Louisville Joint Stock Bank v. Radford, 295 U.S. 555 (1935) was no longer viable case law and was not controlling.

This Court's majority opinion unequivocally states that the bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation, citing Louisville Joint Stock Bank v. Radford, supra. Security Industrial Bank, supra (Slip op. p.4). This Court also rejected the argument that this exercise of the bankruptcy power was a "general economic regulation" (Slip op. p.7).

7. The extent of the governmental taking here is the destruction of the Bank's lien upon the debtors' real property to the extent of the debtor's joint exemption of up to $15,800.00 under Section 522(d) of the 1978 Act. This destruction is a "taking without

compensation", which this Court indicated was prohibited by Radford, supra. Security Industrial Bank (Slip op. pp. 4-6).

WHEREFORE, it is respectfully submitted that this Court's recent unanimous judgment in United States v. Security Industrial Bank, et al. controls and strongly supports granting The Commonwealth National Bank's Petition for Writ of Certiorari and the reversal of the three judge panel decision of the Third Circuit Court of Appeals in this case.

Respectfully submitted,

8 December 1982

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No. 81-1866

In the Supreme Court of the United States

OCTOBER TERM, 1981

COMMONWEALTH NATIONAL BANK, PETITIONER

v.

CHARLES E. ASHE, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
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Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Cases:	Page
Anspach, In re, 13 Bankr. Rep. 208	5
Burkholder, In re, 11 Bankr. Rep. 346	5
Conard v. *Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 386	5
DeBose, In re, 16 Bankr. Rep. 881	4
Griggs, In re, 12 Bankr. Rep. 443	4
Jones, In re, 13 Bankr. Rep. 945	4
Kocher, In re, 12 Bankr. Rep. 126	4
Louisville Joint Stock Land Bank v. *Radford*, 295 U.S. 555	3, 5
Porter, In re, 7 Bankr. Rep. 356	3, 4
Rodrock v. *Security Industrial Bank*, 642 F.2d 1193, probable jurisdiction noted *sub nom. United States* v. *Security Industrial Bank*, No. 81-184 (Dec. 14, 1981)	4, 5, 6
Statutes:	
Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 11 U.S.C. (Supp. IV) 101 *et seq.*	2
11 U.S.C. (Supp. IV 101(27)	5
11 U.S.C. (Supp. IV) 101(37)	5
11 U.S.C. (Supp. IV) 522(d)(1)	2
11 U.S.C. (Supp. IV) 522(f)(1)	1, 2, 3, 4
11 U.S.C. (Supp. IV) 522(f)(2)	4, 5
28 U.S.C. (Supp. III) 160	4
28 U.S.C. 2403(a)	2
41 Pa. Cons. Stat. Ann. § 407(a) (Purdon Supp. 1981)	2

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner contends that the court of appeals erred in holding that 11 U.S.C. (Supp. IV) 522(f)(1) applies to cognovit note judgment liens and that the statute can constitutionally be applied to liens acquired before its enactment.

1. In 1973, petitioner loaned respondents Charles E. Ashe and Susan J. Ashe (the debtors) $45,287.62 (Pet. App. 3a). This loan was evidenced by a promissory note containing a confession of judgment clause in the form commonly used in Pennsylvania (*ibid.*). The note was duly filed with the Prothonotary's Office of the Court of Common Pleas, Dauphin County, Pennsylvania (*id.* at 3a). The loan became delinquent, and, on May 30, 1979, petitioner filed a complaint in assumpsit in order to perfect its right

to execute on the debtors' residential real property (*id.* at 4a; see 41 Pa. Cons. Stat. Ann. § 407(a) (Purdon Supp. 1981)). Petitioner obtained a default judgment for $54,010.83, and a writ of execution was issued (Pet. App. 4a). Actual execution was stayed, however, because, on October 10, 1979, the debtors filed a petition for bankruptcy (*ibid.*).

The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 11 U.S.C. (Supp. IV) 101 *et seq.*, was enacted in November 1978, and the Act became effective on October 1, 1979. Under the Act, a debtor may claim an exemption of up to $7,500 in value in his residence (11 U.S.C. (Supp. IV) 522(d)(1)), and may "avoid the fixing of a lien * * * to the extent that such lien impairs an exemption * * * if such lien is * * * a judicial lien * * *" (11 U.S.C. (Supp. IV) 522(f)(1)). Each of the debtors claimed the maximum exemption with respect to their residence (Pet. App. 5a). Petitioner objected to the debtor's claimed exemptions, and the parties[1] agreed that this objection should be construed as also applying to the question whether the debtors could avoid the lien (*id.* at 18a).[2]

The bankruptcy court held that the lien arising when judgment is entered on a cognovit note is a "judicial lien" within the meaning of 11 U.S.C. (Supp. IV) 522(f)(1) (Pet. App. 18a). It also held

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[1] The United States intervened in the bankruptcy court pursuant to 28 U.S.C. 2403(a).

[2] The fair market value of the debtors' residence at the time they petitioned for bankruptcy was $50,000 (Pet. App. 5a). Prior encumbrances on the debtors' residence having priority under Pennsylvania law over petitioner's lien totalled $9,118.49 (*ibid.*).

that there is no constitutional barrier to avoiding petitioner's lien under that statute, even though the cognovit note was filed and hence technically was acquired prior to the enactment of the Bankruptcy Reform Act,[3] because the judicial lien was not an "interest in property" in the same sense as the mortgage in *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555 (1935).

The court of appeals affirmed (Pet. App. 1a-14a; 669 F.2d 105). It rejected petitioner's assertion that cognovit note judgments are not judicial liens subject to Section 522(f)(1), reasoning that such judgments had been treated as "ordinary judgment liens" by the pre-Bankruptcy Reform Act bankruptcy laws (Pet. App. 7a) and that there is no indication that the Bankruptcy Reform Act intended "something else" (*id.* at 8a). The court also held that application of Section 522(f)(1) to petitioner's lien is constitutional, explaining (Pet. App. 11a):

> It is settled that federal bankruptcy law can eliminate vested property rights in contractual undertakings sanctioned by state law. There is no reason why that plenary power may not, if Congress should say so, operate on property rights, originating out of contractual undertakings, which state law recognizes as liens upon specific property.

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[3] Both courts below assumed that the lien came into existence before the enactment of the Bankruptcy Reform Act because the cognovit note was filed before then. Arguably, however, the lien should not be treated as existing prior to the filing, after default, of the complaint in assumpsit. That filing, which gave rise to a right to levy on the property (see Pet. App. 4a & n.1), was subsequent to the enactment of the Bankruptcy Reform Act. See *In re Porter*, 7 Bankr. Rep. 356, 358-359 (E.D. Pa. 1980).

2. Petitioner's contention (Pet. 8-9) that a lien arising out of a cognovit note judgment is not a "judicial lien" within the meaning of Section 522(f)(1) does not warrant review by this Court. The bankruptcy courts that have passed on the question uniformly have agreed with both courts below that Pennsylvania cognovit note judgments are "judicial liens" within the meaning of Section 522(f)(1). See Pet. App. 5a n.2; see also *In re Jones*, 13 Bankr. Rep. 945 (E.D. Pa. 1981); *In re Griggs*, 12 Bankr. Rep. 443 (E.D. Pa. 1981); *In re Kocher*, 12 Bankr. Rep. 126 (E.D. Pa. 1981); *In re Porter*, 7 Bankr. Rep. 356 (E.D. Pa. 1980).

3. Contrary to petitioner's assertion (Pet. 7), the decision in this case upholding the constitutionality of Section 522(f)(1) does not conflict with *Rodrock* v. *Security Industrial Bank*, 642 F.2d 1193 (10th Cir. 1981), probable jurisdiction noted *sub nom. United States* v. *Security Industrial Bank*, No. 81-184 (Dec. 14, 1981) and *In re DeBose*, 16 Bankr. Rep. 881 (Bankr. App. 9th Cir. 1982).[4] In those cases 11 U.S.C. (Supp. IV) 522(f)(2), which permits a debtor to avoid certain nonpossessory, nonpurchase-money security interests, was held unconstitutional as applied to security interests acquired before its enactment. While it is true that the court of appeals here expressed the view that *Rodrock* was wrongly decided (see Pet. App. 14a), that view was not necessary to its decision, which concerns a different statutory provision.

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[4] *DeBose*, a decision of an appellate panel of bankruptcy judges (see 28 U.S.C. (Supp. III) 160) whose decisions are subject to review in the court of appeals, simply adopts without discussion the analysis and conclusions of *Rodrock*.

Judicial liens are not "security interests" (compare 11 U.S.C. (Supp. IV) 101(27) with 11 U.S.C. (Supp. IV) 101(37); see Pet. App. 19a), and a statutory provision permitting their avoidance does not raise the same constitutional questions as those involved in *Rodrock*. "Unlike a mortgagee, [a judicial lienor] does not look to a specific piece of property from which to satisfy his debt, nor does he have an interest in specific property. Rather, he looks to a general fund of property, if any, owned by the debtor at the time his judgment becomes a lien." *In re Burkholder*, 11 Bankr. Rep. 346, 351 (E.D. Pa. 1981). See also *Conard* v. *Atlantic Insurance Co.*, 26 U.S. (1 Pet.) 386, 443 (1828). As to holding a property interest, petitioner's position is little different from that of a general creditor. Thus, the bankruptcy court correctly concluded (Pet. App. 19a-20a) that the sole basis of the Tenth Circuit's holding in *Rodrock*—this Court's decision in *Louisville Joint Stock Land Bank* v. *Radford*, *supra*—has no application here, where the lien involved is not a right "in *specific* property which [is] of substantial value." 295 U.S. at 601 (emphasis added). See also *In re Anspach*, 13 Bankr. Rep. 208 (E.D. Pa. 1981); *In re Burkholder*, *supra*.

It is the government's view, of course, as explained in detail in our brief in *United States* v. *Security Industrial Bank*, *supra*,[5] that *Rodrock* is incorrectly decided and that retrospective application of Section 522(f)(2) is constitutional. Even if *Rodrock* is affirmed by this Court, however, we believe, for the reasons stated above, that the decision below would not necessarily be called into question. See also note

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[5] We are sending petitioner a copy of this brief.

3, *supra*. The petition for a writ of certiorari should therefore be denied. However, because of the pendency of *United States* v. *Security Industrial Bank*, *supra*, the Court may wish to hold this petition pending the disposition of that case.

Respectfully submitted.

REX E. LEE
Solicitor General

MAY 1982

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